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MEMORANDUM

To: Mayor Libby Schaaf
Council President Larry Reid and Members of the City Council

From: Townsend Public Affairs, Inc.

Date: February 6, 2018

Subject: Ongoing Update of the 2018-2019 State & Federal Budgets

State Budget

As background, TPA sent the City of Oakland a budget update on January 10th. The following report provides greater detail on the Governor's spending proposal.

The January Budget proposal is the starting point for budget negotiations, so it is very possible that allocations will change before the final budget is enacted. In the coming weeks, the Assembly and Senate Budget Committees will hold hearings to discuss various pieces of the Governor's Budget proposal. We will keep the City updated on those hearings and as of the date of this memo, no subcommittee hearings on the Budget have been scheduled.

The Governor's January Budget proposal builds upon the theme of saving for a rainy day, paying down debt, and limiting ongoing spending commitments. The \$190 billion dollar January budget proposal maintains fiscal prudence. The General Fund revenues continue to beat estimates by approximately \$6.1 billion as part of what Governor Brown noted was the longest economic recovery since World War II. These additional revenues will be primarily dedicated to fully funding the Rainy Day Fund, allocating a supplemental \$3.5 billion in the proposed January Budget in addition to the constitutionally required amount under Proposition 2. The Governor was adamant that this action will help the next Administration and the State weather the storm of an inevitable downturn that could result in an annual \$20 billion revenue decline over several years. The Governor also recognized the \$4.6 billion for SB 1 transportation infrastructure, noting that if SB 1 is repealed it could have a devastating impact to California's economy.

The Governor's January Budget does not address the many unknowns resulting from federal policy changes or assumptions coming from the recently passed "Tax Cuts and Jobs Act" signed by President Trump last month. Those impacts will not be known until tax filers complete their 2018 returns in calendar year 2019.



Affordable Care Act

The Governor's January budget proposal includes increased General Fund dollars for the state's portion of the optional Medicaid Expansion under the Affordable Care Act (ACA). As of January 1, the State's share of the cost for the 3.9 million Californians in the expansion population rose from 5 percent to 6 percent, with the federal government providing 94 percent of the cost. The Governor estimates this will cost the state \$1.6 billion General Fund (\$22.9 billion total funds) in 2018-19. By 2020, the state's share will be 10 percent as proscribed by the ACA. Overall costs for the Medi-Cal program are projected to rise by \$543 million in 2018-19 due to payments to the federal government for drug rebate miscalculations and higher overall Medi-Cal managed care costs.

Affordable Housing

The Governor's January budget proposal includes a recap of the ongoing multi-year debate on housing affordability; but the focus is on implementation of last year's 15-bill package. While the specific timing of SB 2 (Chapter No. 364, Statutes of 2017) appropriations remains unclear, the Governor's January budget proposal projects that \$258 million in tax revenues will be generated via SB 2's recording fee in 2018-19. Please note that SB 2 funding in 2018 will be split evenly between grants for local planning activities that promote housing development and statewide grants for homeless services.

Cannabis: Proposition 64 Implementation

Consistent with Proposition 64: The Adult Use of Marijuana Act (AUMA), the Governor's January budget proposal does not include cannabis tax revenues as funding will not be available for allocation until the 2019-20 state budget.

Cap and Trade Funding

In July 2017, Governor Brown signed legislation to extend the cap and trade program through 2030 by a two-thirds super majority vote. This has provided certainty in the cap and trade program which has resulted in stabilized auction results and increased revenues. California will have \$1.25 billion in cap and trade funds available for appropriation in 2018-19. The Governor's proposal calls for the investment of cap and trade auction proceeds into a number of areas:

- Air Toxic and Criteria Air Pollutants
 - \$250 million – AB 617 Community Air Protection (grants to reduce stationary and mobile source emissions in communities heavily impacted by air pollution.)
 - \$5 million – Technical assistance to community groups
- Low Carbon Transportation
 - \$175 million – Clean Vehicle Rebate Project
 - \$160 million – Clean trucks, buses, and off-road freight equipment
 - \$100 million – Enhanced Fleet Modernization Program, school buses and transportation equity projects
 - \$25 million – Low carbon fuel production
- Smart Climate Agriculture
 - \$102 million – Agricultural diesel engine replacement and upgrades
 - \$34 million – Energy efficiency
 - \$5 million – Healthy soils
 - \$4 million – Renewable energy
- Healthy Forests
 - \$160 million – Healthy and resilient forests
 - \$25 million – Local fire response
- Short-Lived Climate Pollutants
 - \$99 million – Methane reduction
 - \$20 million – Waste diversion
- Integrated Climate Action: Mitigation and Resilience
 - \$25 million – Transformative Climate Communities

- \$20 million – California Integrated Climate Investment Program
- \$6 million – Energy Corps
- Climate and Clean Energy Research
 - \$35 million – California Climate Change Technology and Solutions Initiative

In addition to the cap and trade expenditure plan, the Governor also put forth an Executive Order calling for a Zero-Emission Vehicle (ZEV) Investment Initiative that would aim to put five million ZEVs on California roads by 2030, and expand the infrastructure needed to support those vehicles. The ZEV Initiative proposal would be an eight-year initiative to accelerate the sales of zero-emission vehicles through rebates and infrastructure investments. The initiative would provide \$2.5 billion over eight years, and when combined with private investment, will meet a goal of having 1.5 million ZEVs on California roads by 2025 and provide the foundation for the 2030 goal.

Specifically, the Zero-Emission Vehicle Investment Initiative would contain the following investments in 2018-19:

- \$235 million for the California Energy Commission to expand alternative fuel infrastructure through investments in a statewide network of hydrogen and electric fueling stations.
- \$200 million in cap and trade funding for the Air Resources Board to provide rebates to California residents for the purchase or lease of new light-duty zero-emission vehicles and plug-in hybrids.

As was the case last year, the final cap and trade expenditure plan will be subject to negotiation with the Legislature, as part of the budget process. Last year, the Senate and Assembly were not on the same page in relation to how they wanted to structure the expenditure plan, with the Senate favoring direct funding for projects and the Assembly wanting funding to go to a number of existing programs. This year, Pro Tem-Elect Toni Atkins will be leading the budget negotiations for the Senate Democrats, so there could be a change in priorities for the cap and trade funding.

Education

In relation to education, this budget, when combined with the settle-up payments for previous years, proposes an increased investment of \$4.6 billion in K-14 education. Per this budget, ongoing per-pupil spending for 2018-19 will reach \$11,614, which is an increase of \$465 per student from 2017-18. This includes (but is not limited to):

- \$78.3 billion, a new all-time high, for Proposition 98 funding
 - \$3 billion to fully implement the Local Control Funding Formula (LCFF)
 - Along with the fully implemented LCFF, the Governor and Department of Finance (DOF) want to ensure “fiscal transparency.” This means that this budget proposes to require school districts to “show how their budget expenditures align with the strategies detailed in the Local Control and Accountability Plans (LCAPs). It is likely this language will be found in accompanying trailer bill language.
 - \$1.8 billion in discretionary one-time funding
 - \$640 million to fund new construction, modernization, Career Technical Education (CTE), and charter school facility projects as part of Proposition 51 bond funding
 - \$212 million to include K-12 students in the Strong Workforce Program, specifically to encourage the establishment and support of K-12 CTE programs
 - This includes \$12 million to fund local industry experts who will provide technical support to school districts for their CTE programs
 - \$167 million to increase the availability of early education and care for children 0-5
 - \$133.5 million to support a 2.51 percent Cost of Living Adjustment (COLA)
 - \$100 million to increase and retain special education teachers
 - \$50 million to support the Teacher Residency Grant Program

- \$50 million to support the Local Solutions Grant Program, which will be a competitive grant to school districts to develop and implement new solutions to address local need
- \$70.5 million to further implement the California School Dashboard
 - \$55.2 million for county offices of education (COE) to facilitate the “improvement of school districts identified as being in need of differentiated assistance”
 - \$11.3 million for the California Collaborative for Educational Excellence
 - \$4 million to fund a competitive grant program to identify eight lead COEs who will be tasked with providing training, resources, and support for other COEs
- \$10 million to Special Education Local Plan Areas (SELPA) to work with COEs to provide technical assistance to school districts in order to improve student outcomes

Parks Bond (SB 5)

As the City knows, last year the Legislature was successful in securing the passage of a water and parks bond measure, SB 5 (Chapter No. 852, Statutes of 2017) – California Drought, Water, Parks, Climate, Coastal Protection and Outdoor Access for All. SB 5 will place a \$4 billion bond on the June 2018 ballot. If approved by the voters, the measure will provide significant funding for parks, water and wildlife conservation efforts.

State and Local Park Improvements

- *Local and Regional Grant Programs for Neighborhood Parks and Greenway Trails (\$464M)*
 - Safe Neighborhood Parks - \$277 million to provide grants for the creation of new parks and recreation facilities, as well as the rehabilitation of existing local parks, in critically underserved communities throughout California, consistent with the Statewide Park Development and Community Revitalization Program.
 - Per Capita Grants - \$186 million to provide for the acquisition and development of neighborhood, community, and regional parks and recreation lands and facilities in urban and rural areas.
- *State Park Enhancements (\$4M)* – To begin project identification and planning activities necessary to strategically allocate SB 5 funds dedicated to the state park system. Of this amount, \$1.9 million will support implementation of the Redwoods Rising project to enhance old growth coastal redwoods, in collaboration with the National Park Service and Save the Redwoods League.
- *Deferred Maintenance for Fairs (\$4M)*

Ecosystem Restoration & Climate Resiliency

- *River Recreation, Creek, and Waterway Improvements (\$58M)*
- *Salton Sea Restoration (\$30M)* – For the Natural Resources Agency to construct water management infrastructure, habitat conservation and dust mitigation projects, consistent with the Phase I ten-year plan.
- *Climate Adaptation and Resiliency (\$110M)*
- *Coastal Protection (\$13M)*
- *CCC Restoration and Rehabilitation Projects & Grants to Local Community Conservation Corps (\$10M)*

Water Action Plan

- *Safe Drinking Water Projects (\$63M)* – For the State Water Board to provide grants to public water systems in disadvantaged communities for infrastructure improvements to meet safe and affordable drinking water standards, including both drinking water and wastewater treatment projects. Of this amount, \$27 million is available to improve regional water supply within the San Joaquin River watershed.
- *Flood Management (\$99M)* – For flood control projects that achieve public safety and fish and wildlife improvements, as well as funding for a new Floodplain Management, Protection and Risk Awareness Program to protect California's alluvial fan, coastal, and riverine floodplains.
- *Sustainable Groundwater Management Act (SGMA) (\$146M)*
 - SGMA Implementation - \$61.8 million for DWR to support groundwater sustainability agencies through three key efforts: 1) providing technical assistance to aid in the development and evaluation of their plans; 2) supplementing existing planning grants to support a groundwater sustainability agency's responsibility to define a path to achieve sustainable groundwater management; and 3) providing grants directly supporting implementation of groundwater projects.
 - Groundwater Treatment - \$84 million for the State Water Board to support regional groundwater treatment and remediation activities that prevent or reduce contamination of groundwater that serves as a source of drinking water, including \$10 million for technical assistance for drought and groundwater investments.
- *State Water Efficiency and Enhancement Program (\$18M)*

Pension Funding Debt Pay Down

The Governor's January budget proposal continues to provide supplemental pension payments totaling \$6 billion established in the 2017 Budget Act on a quarterly basis to the California Public Employees Retirement System (CalPERS). While this does not offset the pension liability of local agencies, it could have a small improvement on the system-wide funded status.

Property Tax Revenue Projections

Even though property taxes are a local revenue source, a property tax forecast is included in the state budget due to the allocation for K-14 schools offsetting General Fund expenditures. The Governor's January budget proposal anticipates property tax revenues to continue showing positive growth, despite most recent assessments which show a slight decline in the sales of existing single-family homes. In total, the Governor's January budget proposal estimates statewide property tax revenues to increase by almost 6 percent in 2017-18 and 5.6 percent in 2018-19.

Public Safety Communications

The historic wildfires in California demonstrated the need for an enhanced and upgraded 9-1-1 system. The Governor's January budget proposes \$11.5 million in State Emergency Telephone Number Account (SETNA) funds to modernize the state's system and improve public safety during emergency events.

Redevelopment Dissolution

The Governor's January budget proposal restates the priority of the Brown Administration to continue the winding down of redevelopment agencies (RDA), continuing the work that began in 2011. Approximately \$2.6 billion in unrestricted property tax dollars has been returned to counties, \$2.1 billion to cities and \$781 million to special districts from 2011-12 to 2016-17. The combined current budget year and 2018-19 estimates counties will receive an additional \$990 million for their share; cities will receive \$926 million; and special districts will receive \$282 million. Average

ongoing property tax revenues for all local agencies are estimated at \$1.2 billion annually through 2021-22. The Governor's January budget proposal notes General Fund savings through the schools share at \$1.9 billion through 2021-22.

Sales and Use Tax Revenue Projections

Compared to the 2017 Budget Act, the Governor's January budget proposal reflects an improved outlook for sales and use tax revenues. The Administration modified its figures to reflect a projected sales tax revenue generation of \$24.9 billion in 2016-17, \$25.2 billion in 2017-18, and \$26.2 billion in 2018-19. In terms of change, these figures represent increases of \$378 million in 2016-17, \$695 million in 2017-18, and \$426 million in 2018-19.

The Governor's January budget proposal notes that the improved sales tax outlook is due to growth in taxable consumption and business investment. However, the increases do not reverse the long-term trend of deterioration of the sales tax base.

SB 1/Transportation Funding

The Governor's January budget proposal paints a significantly better picture for transportation infrastructure than in years past due largely to the passage of SB 1 (Chapter No. 5, Statutes of 2017) – the Road Repair and Accountability Act of 2017. Over the next decade, SB 1 will provide approximately \$5 billion annually in revenue for local streets and roads, state highways and public transportation through the imposition of new and increased gasoline and diesel taxes and transportation improvement fees.

The Governor's January budget proposal estimates that SB 1 will generate \$2.8 billion in new revenue for transportation infrastructure in 2017-18 and \$4.6 billion in 2018-19. These revenues are in addition to revenues from the base- and price-based gasoline excise tax increments counties, cities, and the State have received in prior years.

SB 1 Repeal Effort

The "Give Voters a Voice" campaign to repeal SB 1 is currently raising money for, and collecting signatures on, an initiative that would require the Legislature to put before the electorate approval of any gas, diesel, or vehicle related tax or fee increase. Since the initiative has a retroactive effective date of January 1, 2017, it would repeal SB 1.

Federal Budget

Federal Budget & Appropriations Overview

- At the federal level, the **budget** is a non-binding, broad outline of spending that is recommended but not required, which is followed by appropriations bills that fund all federal government agencies.
- **Appropriations bills**, which fund the federal government, are traditionally adopted in twelve individual bills pertaining to the various federal departments and agencies. These bills may also advance in the form of a:
 - **Continuing Resolution (CR):** Extension of federal funding for a set amount of time at the same level as previously negotiated
 - **Omnibus:** Full-year funding, all in one bill
 - **Minibus:** Full-year funding, but for several departments at a time
 - **CRomnibus:** Combination CR and omnibus, which negotiates new funding levels for some areas of government and simply extends federal funding at same levels for other areas of government
- In a typical legislative year, Congress begins crafting their annual funding bills after the president submits his proposal in February, followed by appropriation committee hearings in early spring, appropriation bill mark-ups in late spring, floor debate and passage in summer, conference committee negotiations in early fall and final approval by the House and Senate before the September 30 end of the fiscal year.
- However, for the past several years, Congress has been unable to pass all twelve bills in time, and has relied in a series of CRs or omnibus bills.
- An omnibus (and sometimes minibuses) can be unwieldy and under-scrutinized compared to the individual twelve bills, but ultimately, they fund the government in the same way individual appropriation bills would.

FISCAL YEAR 2018 BUDGET AND APPROPRIATIONS

In January, Congress spent the majority of their time in negotiations over a Continuing Resolution to extend funding, while also negotiating for extensions of the Deferred Action for Childhood Arrivals (DACA) program and the Children's Health Insurance Program (CHIP).

When the Senate reached an impasse over immigration legislation, Senate leadership was unable to obtain enough votes to pass a Continuing Resolution to fund the government. After a weekend shutdown that lasted through Monday, January 22, the Senate reached a compromise deal to end the shutdown, fund the government through February 8, and reauthorize CHIP with six years of funding. Since the Governor's January budget assumed that CHIP would be federally funded at 65%, but the extension indicates the first 2 years will be funded at 88%, this means that the California budget has \$900 million in available resources (about \$300 million in 2017-18 and about \$600 million in 2018-19). As a result, the May Revision will likely reflect \$900 million in lower General Fund expenditures, and an equal amount of resources available for any purpose.

However, the Senate was not able to reach an agreement to include statutory protections for DACA recipients. Senate Majority Leader Mitch McConnell committed to holding a vote on a DACA-related bill in the Senate by February 8 as bipartisan negotiations continue. Congressional

leaders must reach another deal prior to Thursday, February 8 to avoid another government shutdown.

FY19 President's Budget Request: The Trump Administration is expected to release its Fiscal Year 2019 budget request on Monday, February 12. Although the President's Budget Request is not considered as a piece of legislation, this announcement will begin Congress's lengthy federal appropriations drafting and negotiation process. The appropriations bills that are passed by Congress and ultimately signed into law as legislation serve as the vehicles that will either fund, eliminate or greatly reduce federal programs. Congress will work through this process over the next several months in anticipation of the 2019 Fiscal Year that will begin on October 1, 2018.

Immigration

DACA Applications Resume: Though DACA issues have been tied closely to the budget and appropriations process, some judicial developments have occurred outside of the negotiations. A San Francisco-based U.S. District Court judge issued a ruling on January 9 ordering the Trump Administration to resume accepting DACA renewal applications. As a result, the federal government announced on January 13 that the DACA program will revert to renewing DACA status in the capacity it did prior to President Trump's announcement rescinding the program. At the time of announcement, the Administration stopped accepting renewals of DACA status.

Infrastructure

Infrastructure Package: President Trump's long-awaited plan for overhauling the nation's crumbling infrastructure includes spending \$200 billion in federal money over the next decade to spur an additional \$1.5 trillion in spending from cities, states and private companies on major projects. Democrats and the U.S. Chamber of Commerce have pushed President Trump to commit far more federal dollars, in part funded by tax increases. For example, the Chamber of Commerce proposed a federal gasoline tax increase this month that it estimates would raise nearly \$400 billion over a decade, as part of a broader infrastructure package that includes private funding, worker training and streamlined permitting.

In President Trump's State of the Union address on January 30, he called on Congress to pass an infrastructure package. Although the Trump Administration will be working with Congress on the package's priorities, it will ultimately be up to Congress to work through the details of how to structure and pay for the package.

The Department of Transportation has indicated that the Trump Administration will release an 80-page document soon that will provide an overview of what they will and will not support in an infrastructure package. The infrastructure package will be a combination of existing funding and new funding; however, any direct funding is expected to be minimal and will be best suited to projects that can leverage additional funds. Additionally, a regional approach will be critical for projects that hope to benefit from an infrastructure package. The proposed infrastructure package is also expected to have provisions for the prioritization of rural projects.

In the next few weeks, it is expected that President Trump will sign an executive order designed to streamline the NEPA permitting and approval process. The Administration will work with Congress to see that the executive order is codified in the infrastructure package.

State of the Union Address

On January 30, President Trump gave his first State of the Union speech to Congress. The speech itself gave few new details on upcoming policies, but below are some indications of future budget and appropriations proposals:

- President Trump called on Congress to pass an infrastructure package “that generates at least \$1.5 trillion” of infrastructure investment.
- President Trump cited workforce development, job training, and vocational schools as areas that need additional attention and investment from Congress. Congress may have a chance to address some of the policies in the planned Higher Education Act reauthorization later this year, but additional funding in the appropriations process will be key.
- President Trump detailed what he’d like to see in an immigration package, which match his previous descriptions. More information on this possible package will be coming out in the next two weeks, as Congress continues their own negotiations. The “four pillars” he described in the speech are:
 - Path to citizenship for Dreamers
 - Border security, including a wall
 - Ending the visa lottery
 - Ending family immigration

Looking Ahead

In the wake of President Trump’s first State of the Union address, Congress will first aim to pass another Continuing Resolution with a negotiated fix for Dreamers, hopefully with an omnibus full-year Fiscal Year 2018 funding bill to follow. After that, Congress will seek to construct an infrastructure package and begin the Fiscal Year 2019 appropriations process.